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# Evaluating the Impact of Small Business Set-Asides on Acquisitions Efficiency

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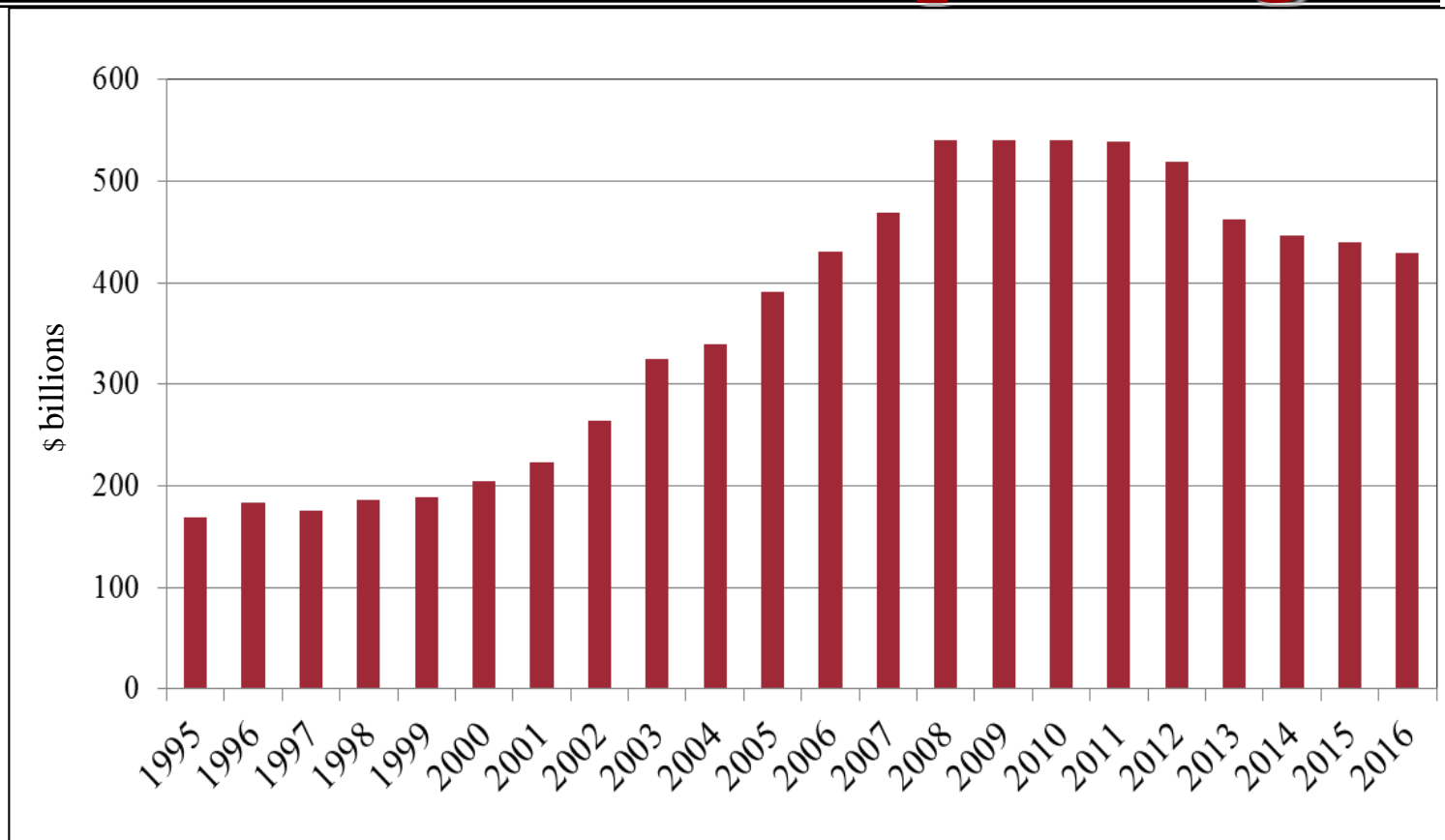
# **Evaluating the Impact of Small Business Set-Asides on Acquisitions Efficiency**

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Naval Postgraduate School  
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# Federal Contract Spending



Federal contract spending, action obligations in \$ billions, 1995-2016

**Spending of this magnitude creates opportunities for implementing socio-economic policies aimed at promoting small businesses.**

# The Evolution of Set-Asides

- ➔ The Small Business Act of 1953 established the policy that the Federal Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small business concerns.
- ➔ **The original goals have become more refined, often adding complexity**
  - For example, Public Law (P.L.) 95-507, enacted in 1978, gave the 8(a) Program statutory authority, more exacting eligibility to stimulate the growth of the minority business community.
  - Other sub-groups were identified and goals established
- ➔ More recently, performance evaluations for all SESs that have an acquisition responsibility have turned the goals into high-pressure requirements
- ➔ **The current government-wide prime contracting goal is 23%.**
  - The initial goal, 20%, was established by Congress in 1988.
  - The current subcontracting goal is 34.03%, and there are also **goals for subcategories of small business.**



# Set-Aside Goals

## FY2015 Government-wide small business procurement goals and achievement

Category	Prime Contracting Goal	Prime Contracting Achievement	Subcontract Goal	Subcontract Achievement
Small Business	23.00%	25.75% (\$90.7B)	34.03%	31.30%
Women Owned Small Business	5.00%	5.05% (17.8B)	5.00%	5.05%
Small Disadvantaged Business	5.00%	10.06% (\$35.4B)	5.00%	10.06%
Service Disabled Veteran Owned Small Business	3.00%	3.93% (\$13.8B)	3.00%	3.93%
HUBZone	3.00%	1.82% (\$6.4B)	3.00%	1.82%

# Research Objective

In its current implementation small business set-aside policy, though admirable in its intentions, may not be rational from an economic or technical standpoint.

➡ **Research Objective:**

- Identify inefficiencies engendered by current set-aside policy
- Analyze unintended consequences of current policy for government and for small business

➡ **Methodology:** We analyzed the distribution of small business federal procurement across industry sectors using the Federal Procurement Data System (FPDS). To contextualize our findings, we interviewed small and mid-sized businesses and government officials.

**The advantages of small business—innovation and agility—have been recognized for decades. Small business is the “driver and engine of growth” and the “lifeblood of our economy.” (Obama, 2014)**

# Set-Aside Goals

➔ The SBA negotiates individual agency goals biannually.

Agency	Prime Contracting Goal	Subcontracting Goal
Department of Agriculture	53.00%	23.00%
Department of Defense	21.60%	36.00%
Department of Education	20.00%	33.00%
Department of Energy	6.00%	50.00%
Department of Homeland Security	32.00%	41.00%
Environmental Protection Agency	40.00%	55.00%
General Services Administration	32.00%	29.00%
NASA	17.00%	36.00%
Office of Personnel Management	25.00%	55.00%
Small Business Administration	69.00%	7.00%

Select agencies FY 2015 small business procurement goals (SBA, 2016)

**Goals vary significantly among agencies and are based, in part, on agency procurement rates by industry.**

# Industry Size Standards

## SBA size standards in select industries

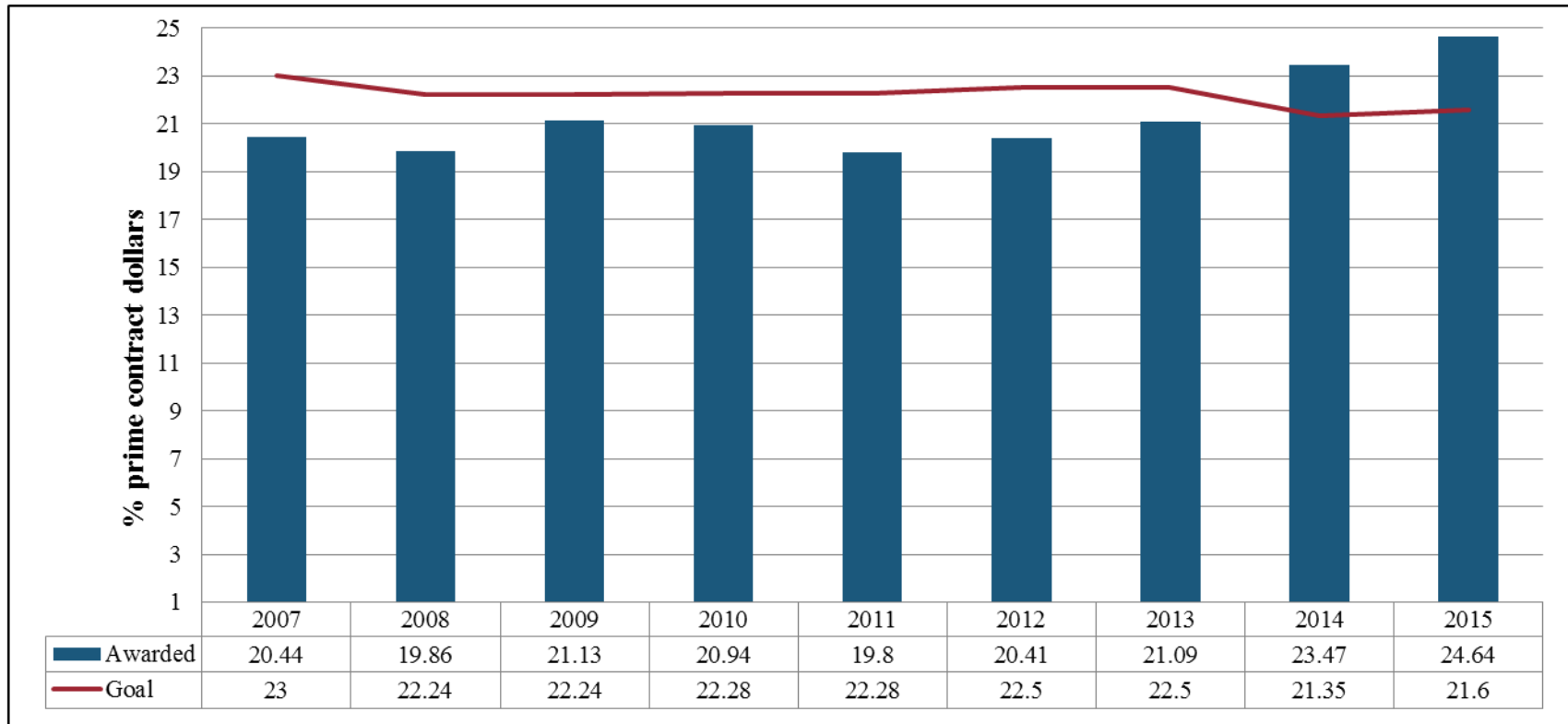
NAICS Industry	Employees	Receipts
Commercial and Institutional Construction	N/A	\$36.5M
Computer-related services	N/A	\$27.5M
Engineering Services	N/A	\$15.0M
Petroleum Refineries	1,500	N/A
R&D in the Sciences	1,000	N/A
Precious Metal Wholesalers	100	N/A

- ➔ The size standard is expressed as the average number of employees over the past 12 months or average annual receipts over the past three years.

**Interpreting the significance of achieving small business procurement goals is complicated by the fact that these industry size standards change periodically.**



# DoD Goals and Achievement



**Following a downward adjustment to its target, the DoD exceeded its prime contracting goal two years in a row.**



# DoD Scorecard (FY 2015)

## Department of Defense FY2015 Small Business Procurement Scorecard

**A**

**106.34%**

FPDS-NG Prime Contracting Data as of Feb. 20, 2016

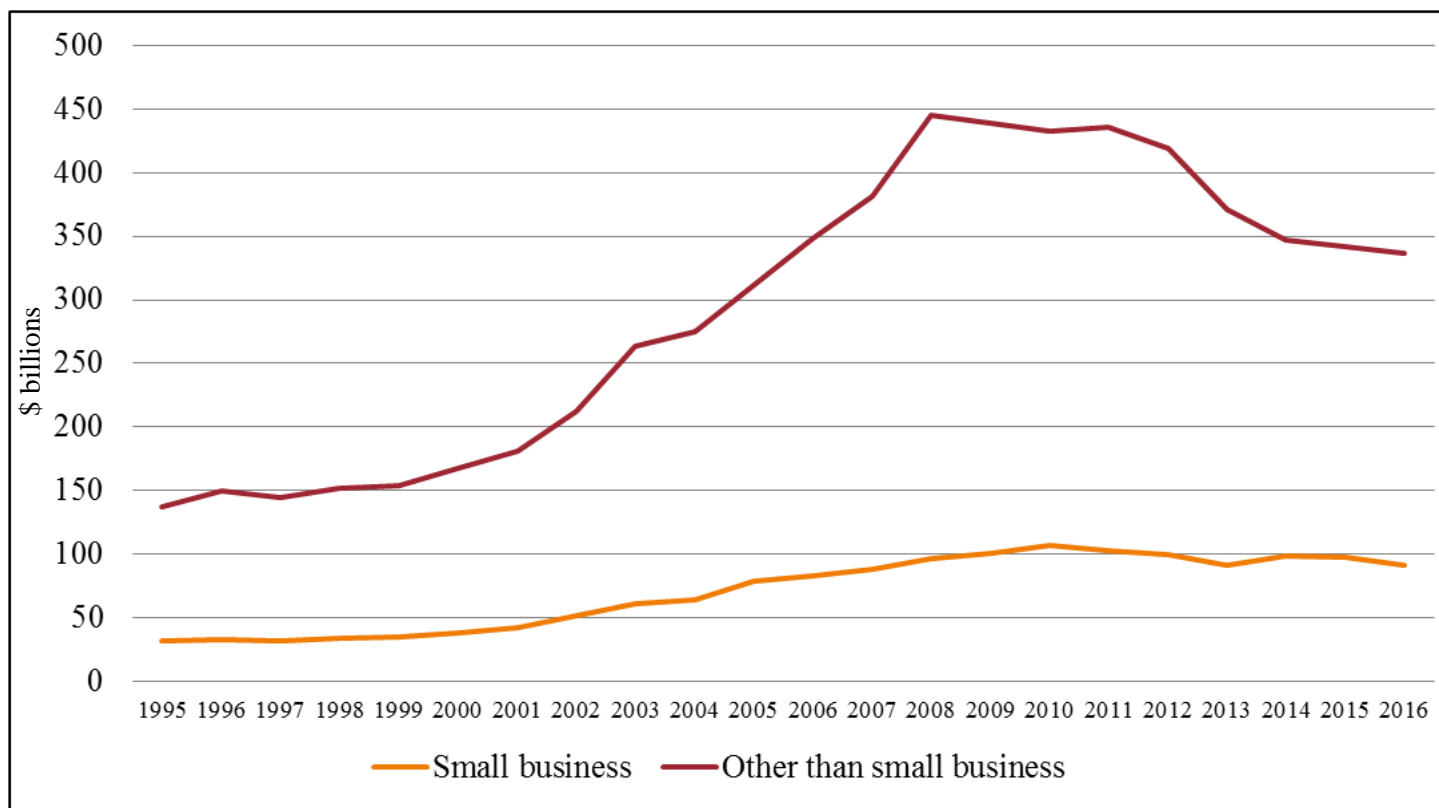
eSRS Subcontracting Data as of Mar. 14, 2016

Prime Contracting Achievement:			88.02%
	2014 Achievement	2015 Goal	2015 Achievement
Small Business	23.47%	21.60%	24.64% (\$52.4 B)
Women Owned Small Business	3.97%	5.00%	4.43% (\$9.4 B)
Small Disadvantaged Business	8.95%	5.00%	9.53% (\$20.2 B)
Service Disabled Veteran Owned Small Business	3.04%	3.00%	3.45% (\$7.3 B)
HUBZone	1.93%	3.00%	1.87% (\$4.0 B)

Subcontracting Achievement:			8.46%
	2014 Achievement	2015 Goal	2015 Achievement
Small Business	33.20%	36.00%	32.30%
Women Owned Small Business	5.70%	5.00%	5.30%
Small Disadvantaged Business	4.60%	5.00%	4.40%
Service Disabled Veteran Owned Small Business	2.10%	3.00%	2.00%
HUBZone	1.50%	3.00%	1.40%

**An agency's grade is composed of three weighted measures: prime contracts (80%), subcontracts (10%), and its "progress plan" for meeting future goals (10%).**

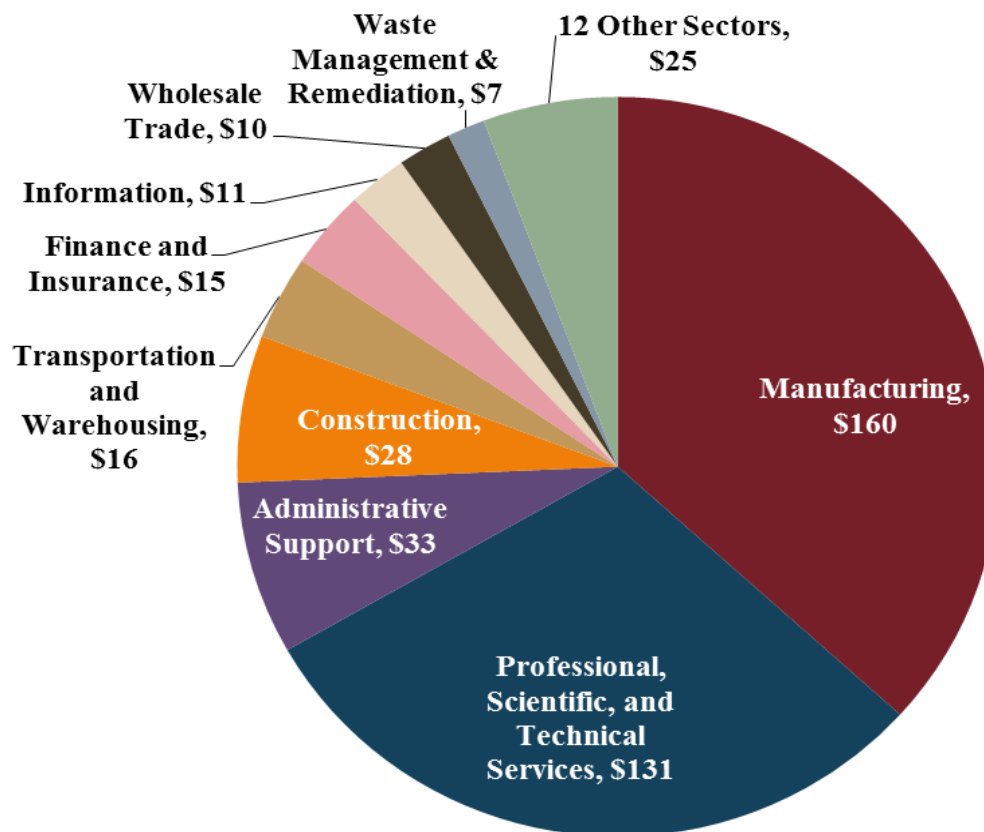
# Trends in Small Business Contracting



**Federal contract spending, action obligations in \$ billions, 1995-2016**

**The goal was met in 2014 and 2015 despite, and in part because of, the continued decline in contracting with traditional firms.**

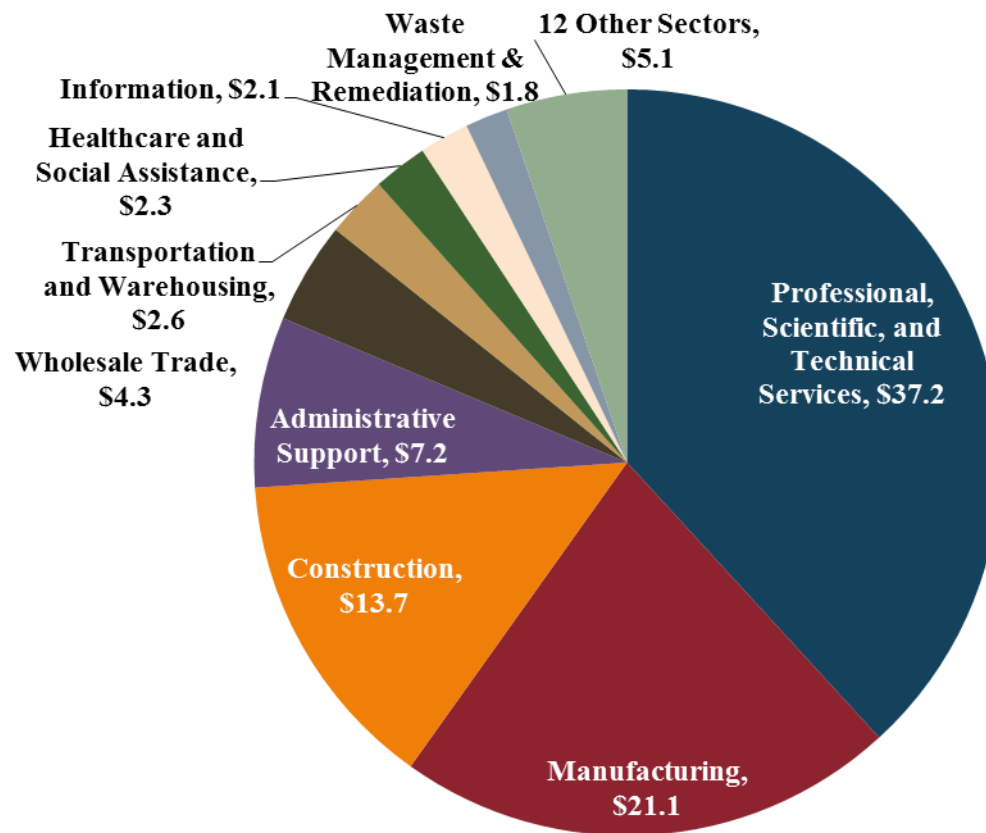
# Federal Procurement by Sector



FY 2015 federal contract obligations (\$ billions) by industry sector

**Manufacturing; professional, scientific, and technical services; construction; and administrative support sectors account for more than 80% of federal procurement**

# The Small Business Picture

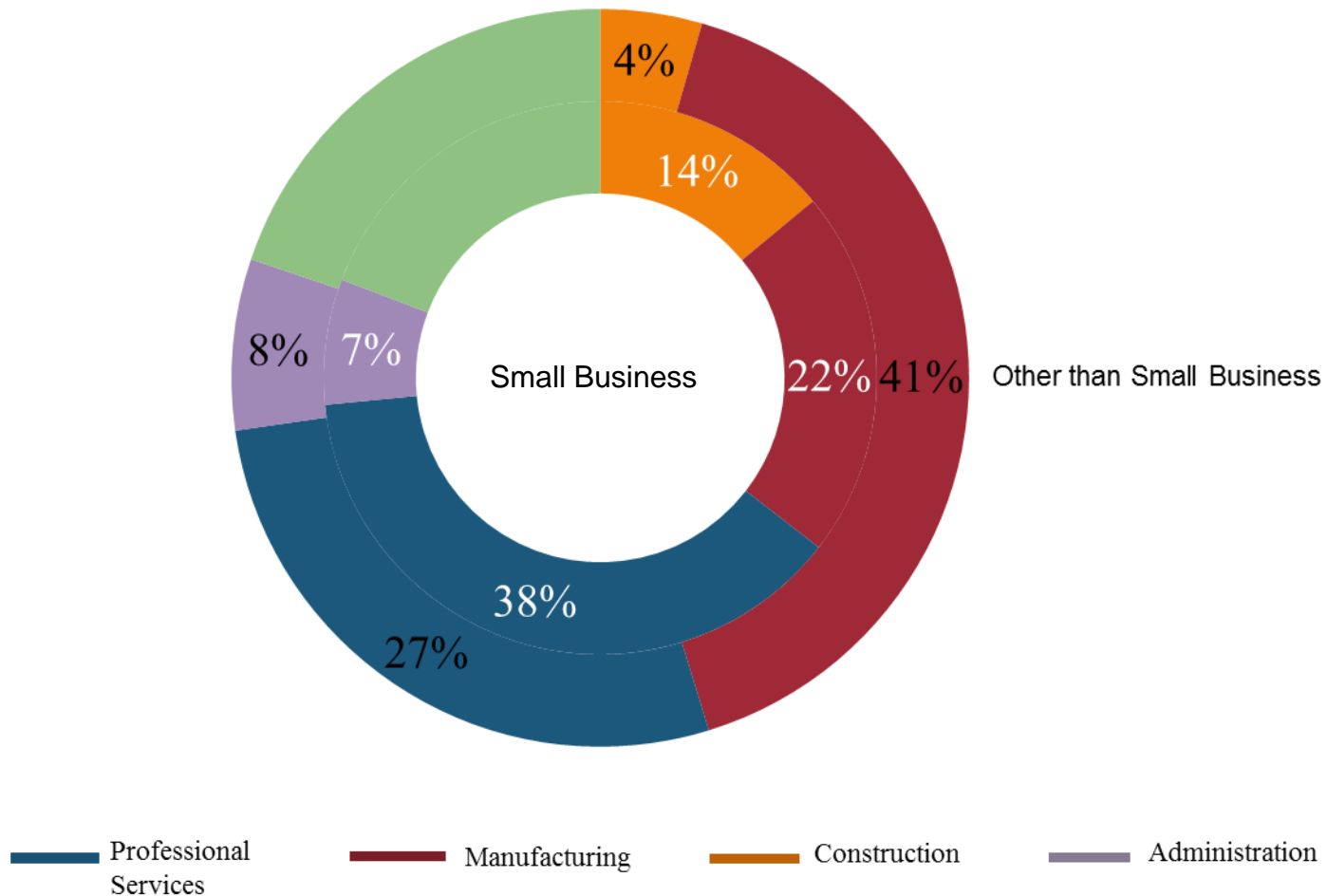


FY 2015 small business federal contract obligations (\$ billions) by industry sector

**The same four sectors dominate. However two sectors, construction and professional services account for relatively larger pieces of the pie; manufacturing accounts for a smaller piece.**

# Procurement in the Four Major Sectors

FY 2015 action obligations by sector



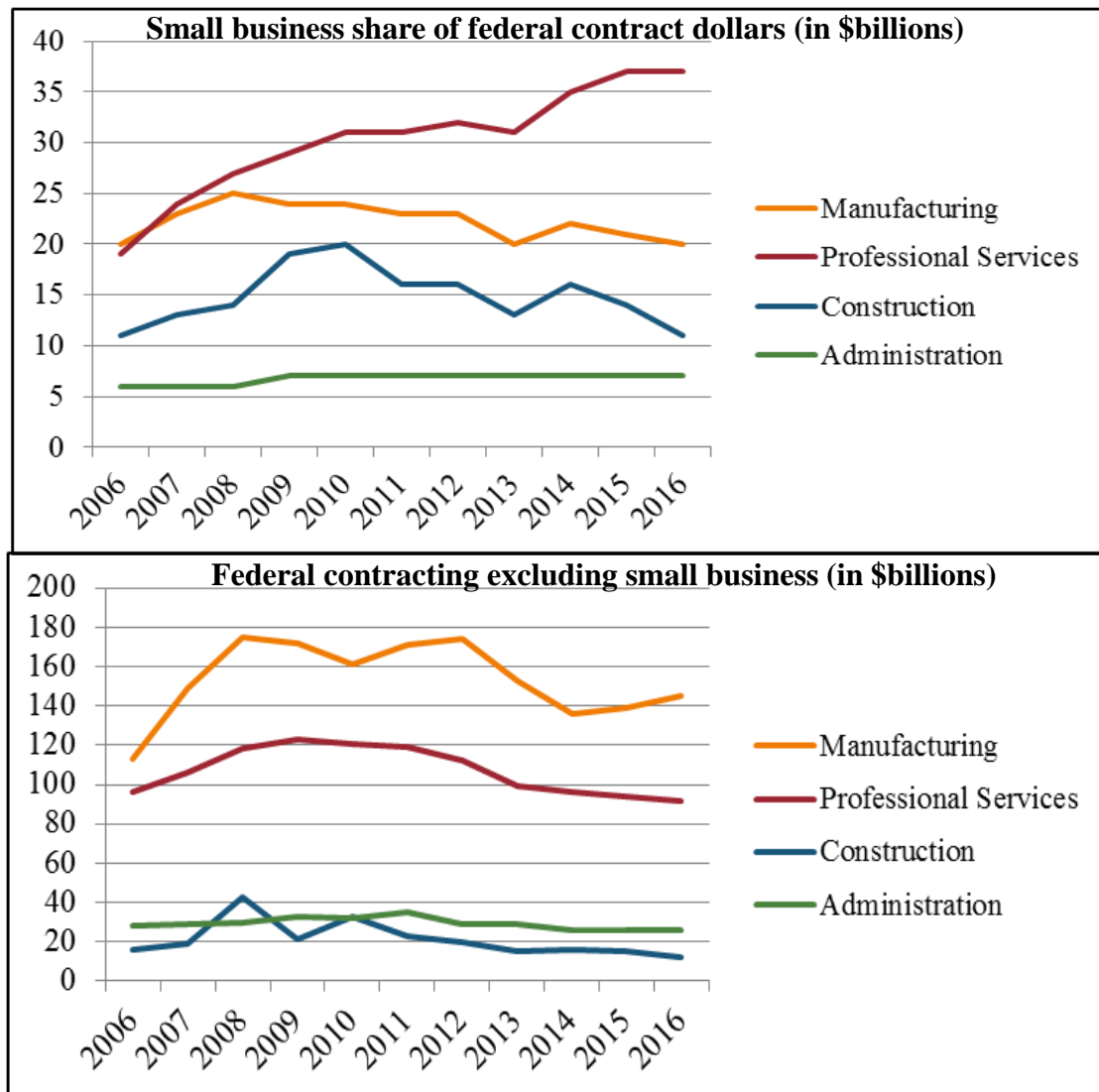
# The Small Business Potential

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- ➔ To significantly increase the small business share of federal contracting dollars you must focus on the four sectors, where the overall level of federal procurement is relatively high.
  - For instance, small business dominates the agricultural sector, with 76% of all procurement dollars (in FY 2015) awarded to small business, but this figure translates to only \$318 million.
- ➔ There are challenges. In the construction sector, for example, nearly half—47%— of all contracting dollars already flow to small business.
- ➔ As for manufacturing, the bulk of contracting dollars are spent in highly-specialized industries such as aerospace and the manufacture of military systems.
  - These industries require extensive capital investment, a large operating footprint, and extensive logistics networks.

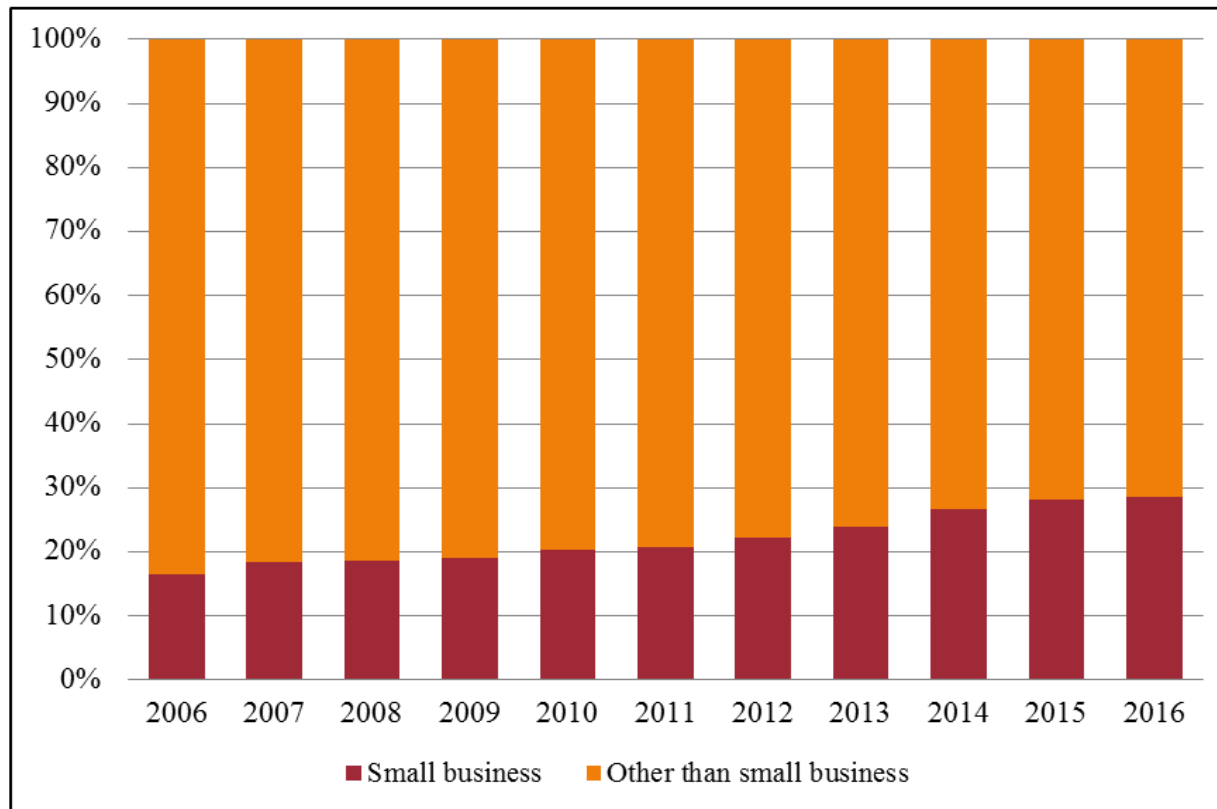
# Trends in the Four Major Sectors

- ➔ Small business has lost ground in the construction and manufacturing sectors, but has gained steadily in the professional, scientific, and technical services sector.
- ➔ These trends are not necessarily representative of federal procurement in general.





# The Professional Services Sector



Small business participation in federal contracting, professional services sector,  
(percentage of action obligations (\$))

**The small business share of federal contracting dollars in the professional services sector grew from 15% in 2006 to 29% in 2016.**

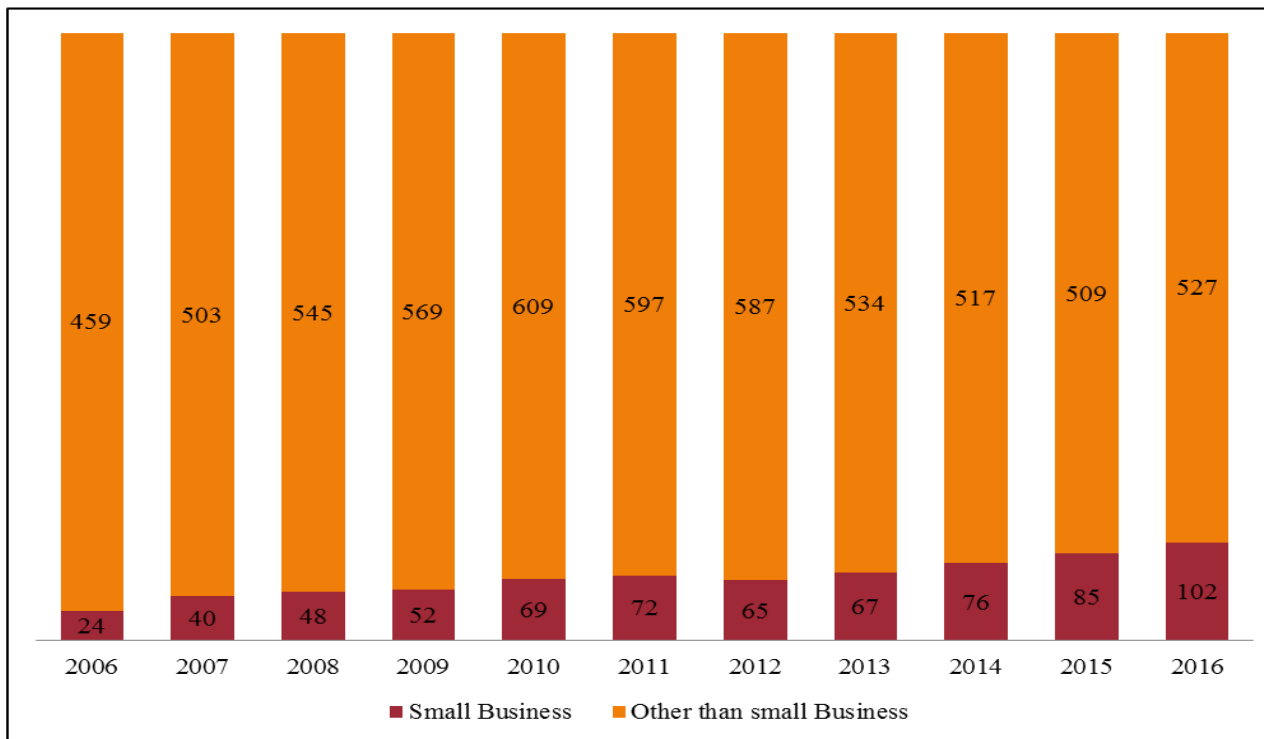
# Unintended Consequences

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- ➔ Set-aside policy will have the continued effect of concentrating more federal contract spending into the growing professional services sector, generating unintended consequences. These include:
  - For small business
    - Uneven and unsustainable growth
    - Significant barriers to entry
  - For government
    - Contracting and economic inefficiency

# Uneven and Unsustainable Growth

Small professional services providers are receiving more large contracts, hastening their growth trajectory such that they are no longer eligible for set-asides; often, these firms lack capability to compete under free and open competition.



Number of large contracts (> \$25 million) awarded annually in the professional services sector

**According to Rep. Gerald Connolly (D-VA): “Innovative, high performing small businesses are becoming victims of their own success– graduating from small business programs only to find themselves in the untenable position of facing off against multi-billion dollar firms.”**

# Barriers to Entry

- ➔ Government agencies have turned increasingly to multiple-award indefinite delivery / indefinite quantity contracts (MA/IDIQ), often in the form of Government-wide Acquisition Contracts.
  - As of 2016, well over 300 agencies (e.g. USA, USAF, NAVAIR, DISA, and DLA) have made a decision to transition large portions of their professional services portfolio over to the GSA OASIS GWAC.
- ➔ Total procurement obligations under multiple-award contracts exceeded \$80 billion in 2011, double the amount in 2006 (Robinson, 2013).
- ➔ Because MA/IDIQs tend to have relatively long periods of performance, often up to five years, and few “on ramps,” the contracts tend to limit participation.

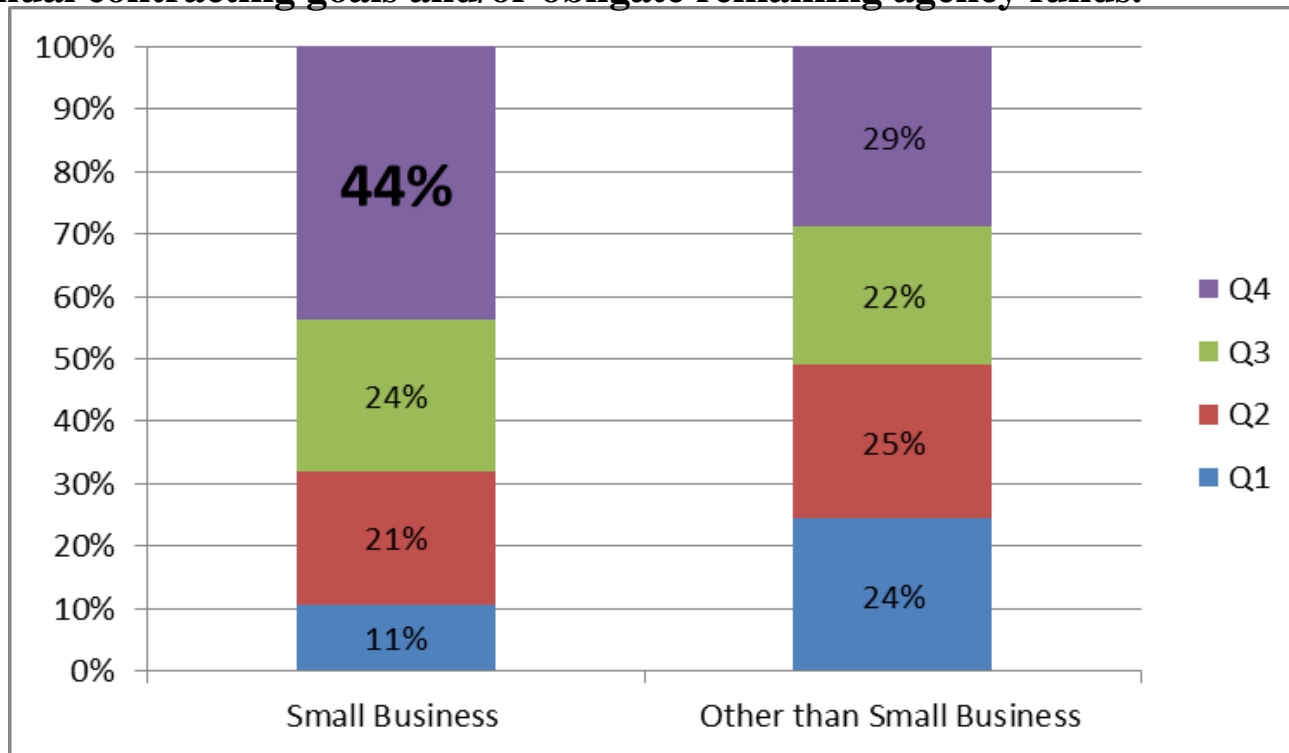
**Increased reliance on multiple award contracts favor a select group of small firms, but “shut out” the majority.**

# Contracting and Economic Inefficiency

- ➔ CSIS found that from 1999 to 2009, the share of DoD contracts awarded to mid-sized firms decreased (from 36.0% to 28.9%)
  - This can lead to higher prices as a result of less competition among established firms.
  - The government may lose access to capitalized capabilities such as test and evaluation facilities.
- ➔ Rather than pursue growth and diversification, some small firms choose to limit growth and remain small to continue to qualify for small business set-aside contracts.
- ➔ Contracting officers have been known to “code shop”.
  - For example, the “R&D” NAICS code (size standard 1000 employees) is used in place of the more appropriate “engineering services” (size standard \$15 million).
- ➔ When the small prime lacks the necessary infrastructure and capabilities, it may subcontract much of the work to a large firm.
  - The large firm is then “managed” by the small firm, likely increasing costs to the government.

# Contracting and Economic Inefficiency

Critics have asserted that the timing of small business awards—concentrated at the end of the fiscal year—represents agencies’ attempts to meet their annual contracting goals and/or obligate remaining agency funds.



Timing of contract awards (\$), 10-year average (2007-2016)

**Efforts made to spend funds quickly likely fail to maximize taxpayer value.**

# Recommendations

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## ➔ Set reasonable agency goals

- When goals are too high, the intended benefits give way to inefficiency.
- Consider development of a single agency goal that includes both prime and subcontract dollars, adjusting the calculation and grading methodology (placing greater weight on the subcontracting goal) to account for small businesses participating at all tiers of agency contracts.

## ➔ Evaluate the impact of set-asides on the industrial base.

- Ensure that agencies' small business goals are not so high that graduated, mid-sized firms are deprived of opportunities to compete under free and open competition; set-aside policy should encourage the best small businesses to grow.

## ➔ Review NAICS code descriptions

- When industry groups are too broad, inappropriate codes (and, as a result, size standards) may be used.
- These thresholds must be clear and unambiguous.

# Recommendations

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## ➔ Cap eligibility for set-asides.

- The SBA should discourage the formation of “permanent small businesses”—i.e. those firms that have no inclination to grow beyond the relevant industry size standards.

## ➔ Set aside contracts that small business can handle.

- Large contracts have the potential to overwhelm small firms’ infrastructure and capabilities; agencies should unbundle large contracts.

## ➔ Review the use of MA/IDIQs and GWACs.

- Many small businesses are effectively “shut out” of some of the federal government’s most lucrative contracts.
- Those that are fortunate enough to be awarded IDIQs face high bid and proposal costs in that they must then also bid for an individual task order.

## ➔ Strengthen the government acquisition workforce.

- Shortfalls within the government acquisition workforce are partially responsible for agencies’ increasing reliance on GWAC and other MA/IDIQ contract vehicles and may also explain the timing of set-aside awards (toward the end of the fiscal year).